THE FEDERAL FARM LOAN ACT.

PROVIDES SYSTEM FOR LENDING MONEY ON FARM LANDS AT REASONABLE INTEREST FOR RELATIVELY LONG PERIODS—AMORTIZATION PLAN FOR EASY PAYMENTS PRESCRIBED—ATTRACTS MONEY TO FARM LOAN FIELD BY PROVIDING SAFE INVESTMENTS IN BONDS BASED ON SECURITY OF FIRST MORTGAGES.

OUTLINE OF FARM LOAN ACT.

The act provides for the creation of 12 Federal land banks and permits the establishment of any number of joint-stock land banks for the purpose of making loans at a reasonable rate of interest, for long periods of time, on farm lands.

A Federal Farm Loan Board has complete control over these banks.

(A) FEDERAL LAND BANKS.

Twelve Federal land banks are provided, one in each of 12 districts into which the country will be divided. These banks are empowered to lend on first mortgages on farm lands in amounts of $100 to $10,000 for approved purposes. The loans are to be made through farm loan associations and agents. No loan may be made for more than 50 per cent of the value of the land mortgaged and 20 per cent of the value of the permanent improvements upon it.

National farm loan associations—local organizations composed exclusively of borrowers—are authorized. These associations must be stockholders in the land banks in proportion to the amount their members wish to borrow. Eventually all stock in the Federal land banks will be owned exclusively by these associations.

A reasonable interest rate is established. The act prohibits the Federal land banks from charging more than 6 per cent on any mortgage, or requiring fees not approved by the Farm Loan Board.

The borrowers will share in the net profits of the bank because they are stockholders. It is contemplated that ultimately the borrowers will be the only stockholders.

Long-term loans are provided by authorizing mortages for periods of from 5 up to 40 years.

Small annual or semiannual payments on the principal are made a required feature of all mortgages.

(B) JOINT-STOCK LAND BANKS.

Joint-stock land banks are authorized. They are corporations for carrying on the business of lending on farm mortgage security and issuing farm loan bonds. They are to be under the supervision of the Farm Loan Board, but the Government will not invest in them. Subject to geographical limitations and subject to the 50 and 20 per cent limitation, these banks can lend to an individual any amount they wish, and for any purpose. They can not charge an interest rate exceeding 6 per cent, and such rate must not exceed by more than 1 per cent the interest they have paid on their last issue of bonds. Their mortgages, however, must provide for amortization payments. These banks are prohibited from charging, under any pretext, fees or commissions other than those authorized by the act.

The Federal farm loan act, popularly called the "Rural credits law," was signed by the President and became a law on July 17, 1916.

The primary purpose of this act is to promote agricultural prosperity by enabling farmers to borrow money on farm-mortgage security at a reasonable rate of interest and for relatively long periods of time. To attain this object, two farm-mortgage systems are provided: (1) A system operating through regional land banks, and (2) a system operating through joint-stock land banks.

To attract money to the farm-loan field the act provides a method whereby those who have money to lend can find safe investment in the form of debentures or bonds, of small and large denominations, issued by the banks and based on the security of mortgages on farm lands.

These two systems are to be under the general supervision of a Federal Farm Loan Board in the Treasury Department, composed of the Secretary of the Treasury, as chairman ex officio, and four members appointed by the President. This board has authority to appoint appraisers, examiners, and registrars, who will be public officials.

FEDERAL LAND-BANK SYSTEM.

Under the Federal land-bank system the act provides for Federal land banks which make loans, for the first 12 months, exclusively through local national farm-loan associations composed of borrowers. These associations shall be shareholders in the banks, and in that way the members who are the borrowers will share in the profits of the bank. The money for the loans is to come partly from the capital of the banks and partly from the sale by the banks of bonds secured by first mortgages on farm lands. The act defines strictly the purposes for and the conditions under which loans are to be made, and requires that the rate of interest charged on farm loans shall not exceed 6 per cent per annum.

Twelve Federal Land Banks.

The United States shall be divided into 12 farm-loan districts, and a Federal land bank with a subscribed capital stock of not less than $750,000, each share $5, shall be established in each district. Each Federal land bank may establish branches in its district. Within 30 days after the capital stock is offered for sale it may be purchased at par by anyone. Thereafter, the stock remaining unsold shall be bought by the Secretary of the Treasury for the United States. It is provided, however, that the Government shall not receive any dividends on its stock. Ultimately, it is intended that all the stock in the banks shall be owned by the associations of borrowers, and provision therefore is made in the law for transferring the original stock at par to these associations.

National Farm-Loan Associations.

The act provides for the creation of local national farm-loan associations through which it is contemplated that the Federal land bank shall make their loans. In the event that a local loan association is not formed in any locality within a year, the Federal Farm Loan Board may authorize a Federal land bank to make loans on farm land through approved agents. Ten or more persons who own and cultivate farm land qualified as security for a mortgage loan under the act, or who are about to own and cultivate such land, may form such an association, provided the aggregate of the loans desired by the membership is not less than $20,000. Each member must take stock in his association to an amount equivalent to 5 per cent of the amount he wishes to borrow. This stock the association holds in trust as security for the member's individual loan. The association, in turn, when applying for money from the bank, must subscribe for stock in the bank to an amount equivalent to 5 per cent of the sum it wants to obtain for its members. This stock is held in trust by the bank as security for the loans it makes through the association. If a prospective borrower has no money with which to pay for his association stock, he may borrow the price of that stock as a part of the loan on his farm land.

Under this plan, then, every borrower must be a stockholder in his local association, and every association a stockholder in its district bank. Each stockholder in an association is liable for the acts of that association up to twice the amount of his stock.

How Loans Are Obtained.

A member of a national farm loan association, before obtaining a loan, must first fill out an application blank supplied to the loan association by the Federal Farm Loan Board. This application blank and other necessary papers will then be referred to a loan committee of the association which must appraise the property offered as security. Such application as is approved by the loan committee is then forwarded to the Federal land bank and must be investigated and reported on by a salaried appraiser of the bank before the loan is granted. This appraiser is required to investigate the solvency and character of the prospective borrower as well as the value of his land. When a loan is granted the amount is forwarded to the borrower through the loan association.

Conditions Under Which Loans May Be Obtained.

The act specifically defines the purposes for which loans may be obtained. These are:

(*a*) To provide for the purchase of land for agricultural uses.

(*b*) To provide for the purchase of equipment, fertilizers, and live stock necessary for the proper and reasonable operation of the mortgaged farm; the term "equipment" to be defined by the Federal Farm Loan Board.

(*c*) To provide buildings and for the improvement of farm lands; the term "improvement" to be defined by the Federal Farm Loan Board.

(*d*) To liquidate indebtedness of the owner of the land mortgaged, existing at the time of the organization of the first national farm loan association established in or for the county in which the land mortgaged is situated, or indebtedness subsequently incurred for one of the purposes mentioned in this section.

Loans may be made only on first mortgages on farm land.

Only those who own and cultivate farm land or are about to own and cultivate such land are entitled to borrow.

No one can borrow save for the purposes stated in the act, and those who after borrowing do not use the money for the purposes specified in the mortgage are liable to have their loans reduced or recalled. The secretary-treasurer of each association is required to report any diversion of borrowed money from the purposes stated in the mortgages.

No individual can borrow more than $10,000 or less than $100.

No loan may be made for more than 50 per cent of the value of the land mortgaged and 20 per cent of the value of the permanent insured improvements upon it.

The loan must run for not less than 5 and not more than 40 years.

Every mortgage must provide for the repayment of the loan under an amortization plan by means of a fixed number of annual or semiannual installments sufficient to meet all interest and pay off the debt by the end of the term of the loan. The installments required will be those published in amortization tables to be prepared by the Farm Loan Board.

The bank is given power to protect itself in case of default by recalling the loan in whole or in part, or taking other necessary action.

The Interest Rate Paid by the Borrower.

No Federal land bank is permitted to charge more than 6 per cent per annum on its farm-mortgage loans, and in no case shall the interest charged on farm mortgages exceed by more than 1 per cent the rate paid on the last issue of bonds.

For example, if the bank pays only 4 per cent on an issue of bonds, it can not charge more than 5 per cent for the next farm loans it makes.

Out of this margin of not to exceed 1 per cent, together with such amounts as it can earn on its paid-in cash capital, the bank must set aside certain reserves and meet all its expenses. Any balance or net profits can be distributed as dividends to the loan associations or other stockholders. The loan associations, from their bank dividends, after setting aside the required reserves and meeting expenses, can declare association dividends to their members. In this way the profits, if any, will be distributed among the borrowers and will, to that extent, reduce the amount of interest actually paid by them.

Restriction on Fees and Commissions.

The Federal land banks are specifically prohibited from charging, in connection with making a loan, any fees or commissions which are not authorized by the Farm Loan Board. The authorized fees need not be paid in advance, but may be made part of the loan.

Amortization Plan of Repaying Loans.

It has been said that all loans are to be repaid on the amortization plan. This plan calls for a number of fixed annual or semiannual payments, which include not only all interest and charges due the bank, but the principal as well. These payments are so calculated as to extinguish the debt in a given number of years. After five years the borrower has the right on any interest date to make additional payments on the principal in sums of $25 or any multiple thereof, thus discharging the debt more quickly.

The table given below illustrates how a loan of $1,000, bearing interest at 5 per cent, would be retired in 20 years by an annual payment of $80.24. A study of the columns shows how from year to year the interest is reduced and the proportion of the payment which goes to discharge the principal steadily increases. The final payment cancels the debt.

Annual periods.	Total annual payment.	Interest at 5 per cent.	Paid on principal.	Amount of principal still unpaid.
1	$80.24	$50.00	$30.24	$969.76
2	80.24	48.49	31.75	938.01
3	80.24	46.90	33.34	904.67
4	80.24	45.23	35.01	869.66
5	80.24	43.48	36.76	832.90
6	80.24	41.65	38.59	794.31
7	80.24	39.72	40.52	753.79
8	80.24	37.69	42.55	711.24
9	80.24	35.56	44.68	666.56
10	80.24	33.33	46.91	619.65
11	80.24	30.98	49.26	570.39
12	80.24	28.52	51.72	518.67
13	80.24	25.93	54.31	464.36
14	80.24	23.22	57.02	407.34
15	80.24	20.37	59.87	347.47
16	80.24	17.37	62.87	284.60
17	80.24	14.23	66.01	218.59
18	80.24	10.93	69.31	149.28
19	80.24	7.46	72.78	76.50
20	80.33	3.83	76.50	....
Total	1,604.89	604.89	1,000.00	....

Funds Available for Loans.

After a Federal land bank has loaned on first mortgage $50,000, it can obtain permission from the Farm Loan Board to issue $50,000 in farm loan bonds based on these mortgages, sell such bonds in the open market, and use the money thus obtained to lend on other mortgages.

This process of lending on mortgages and selling bonds in issues of $50,000 may be repeated until bonds to the amount of twenty times the bank's paid-up capital are outstanding. If each bank should have only its required minimum paid-up capital of $750,000, this plan will provide eventually, if all the authorized bonds of the 12 banks are sold, over $180,000,000 to lend on first mortgages on farm land. The banks, however, can increase their capital stock above the required minimum and so increase the amount of bonds they can sell, and thus increase the total amount of money available for loans on farm mortgages.

To make these bonds attractive to investors, the bonds, together with the mortgages upon which they are based, are exempted from Federal, State, municipal, and local taxation and are made legal investments for fiduciary and trust funds. The capital stock of the Federal land banks is also exempt from taxation. Federal reserve banks and member banks of that system are empowered to buy and sell these bonds. They are to be issued in denominations of $20, $50, $100, $500, and $1,000.

Organization of Banks.

The temporary management of the Federal land banks is to be in the hands of five directors appointed by the Federal Farm Loan Board. As soon, however, as the subscriptions from the loan associations total $100,000 regular directors are to be appointed as follows: Three district directors, resident in the district, shall be appointed by the Federal Farm Loan Board to represent the public interest, and six local directors, resident in the district, shall be elected by the farm loan associations who must be stockholders in the bank. The Federal Farm Loan Board shall designate one of its appointees to act as chairman. The act requires that at least one of the three district directors shall be experienced in farming and actually engaged at the time of his appointment in farming operations within the district. Any compensation paid to the directors must be approved by the Federal Farm Loan Board.

Officers of Loan Associations.

Each loan association must have a board of directors and a secretary-treasurer. The directors shall serve without pay. The secretary-treasurer shall receive such compensation as may be determined by the board of directors. The association must appoint an appraisal committee for the purpose of valuing lands offered as security for loans. No member of such committee shall have any interest in the property upon which he passes.

FUNDS FOR CURRENT EXPENSES.

To provide funds for current expenses, the loan association may retain as a commission from each interest payment not to exceed one-eighth of 1 per cent semiannually upon the unpaid principal of the loan. This commission is to be deducted from the dividends payable to such farm loan association by the Federal land bank. If the commissions are not adequate, and an association does not wish to assess members for current expenses, it may borrow at 6 per cent from the Federal land bank to an amount not to exceed in the aggregate one-fourth of its bank stock.

RESERVES AND DIVIDENDS.

The law requires both the land banks and the farm loan associations to make provision for certain reserves before they can pay any dividends.

Agents and Land Banks.

In sections where local conditions do not make the formation of associations practicable, the Farm Loan Board may authorize the Federal land bank to make loans through agents approved by the board. These agents are to be banks, trust companies, mortgage companies, or savings institutions, chartered by the State. They may receive as compensation the actual expense involved in transacting the loan and in addition thereto a sum not to exceed one-half of 1 per cent per annum on the unpaid principal of the loans made through them. When the Farm Loan Board decides that a locality is adequately served by farm loan associations, no further loans are to be made through agents.

JOINT-STOCK LAND BANKS.

In addition to the system of 12 Federal land banks and the national farm loan associations of borrowers, the act permits the establishment of joint-stock land banks and authorizes them to carry on the business of lending directly to borrowers on farm-mortgage security and issuing farm loan bonds. These banks must have a capital of not less than $250,000. They are under the supervision of the Federal Farm Loan Board, but the Government does not lend them any financial assistance.

The joint-stock land bank is free from many of the conditions imposed on the Federal land banks. Subject to the 50 and 20 per cent value limitation and the limitation as to territory, the joint-stock land bank may lend more than $10,000 to a single individual, and it is not restricted to making loans for the purposes specified in the case of the Federal land bank.

The joint-stock bank, like the Federal land banks, can not charge an interest rate on farm mortgages in excess of 6 per cent, nor shall such interest rate exceed by more than 1 per cent the rate of interest paid by the bank upon its last issue of bonds. A joint-stock bank is limited in its bond issue to 15 times its capital and surplus.

Among the restrictions placed on these banks under the act are (1) that their mortgages must provide for an amortization system of repayment such as is prescribed in the case of loans through the Federal land banks, and (2) that they shall in no case demand or receive under any form or pretense any commission or charge not specifically authorized by the act and approved by the Farm Loan Board.

The bonds of the joint-stock land banks are exempted from taxation. Their capital stock, however, is not exempted.

GENERAL PROVISIONS.

The law, through the Farm Loan Board, provides the necessary machinery for frequent examinations of the banks and the associations, for the proper cancellation of mortgages, and for the safe custody of mortgages offered as security for bonds. When any mortgage offered as security for bonds is withdrawn, the bank is required to replace the security with other mortgages or with other satisfactory collateral.

Heavy penalties of fine or imprisonment, or both, are imposed for violations of the act, malfeasance in office, fraud, embezzlement, defalcation, or other illegal practices.

53040—16

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1916